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UNCLAS SECTION 01 OF 03 ANKARA 006165

SIPDIS

SENSITIVE

STATE FOR E, EB/IFD AND EUR/SE
TREASURY FOR OASIA - MILLS AND LEICHTER
NSC FOR BRYZA AND MC KIBBEN
USDOC FOR 4212/ITA/MAC/OEURA/DDEFALCO

E.O. 12958: N/A
TAGS: ECON EINV EFIN PGOV TU
SUBJECT: PRIVATIZATION UPDATE

REF: A. ANKARA 1447
¶B. ANKARA 2130
¶C. ANKARA 5075
¶D. ANKARA 1913
¶E. ANKARA 6144

¶1. (SBU) Summary. After years of slow motion on privatization, IMF conditions and the AK government,s more business-oriented approach seems to have led to a decisive phase in Turkey,s privatization program. How serious the GOT has become will be known by the end of the year, by when three of the largest SEEs (Tekel, Tupras and Petkim) are scheduled to have been sold. In 2004, a second wave of important sales is supposed to occur. End Summary.

TEKEL

¶2. (U) As noted in Ref A, Tekel,s tobacco operations have attracted substantial interest from, among others, Phillip Morris, British American Tobacco, and Japan Tobacco. Press reports value the tobacco subsidiaries at between $1.7 billion and $4.0 billion, which reflect primarily the difficulty of determining how much new capital is needed to modernize the operations. Although the alcohol subsidiaries are also for sale, they represent only about 20% of the value of the company and have not attracted as much interest.

¶3. (SBU) Bids for Tekel were originally due on September 26, but the deadline has since been extended to October 24. Privatization Authority (PA) VP Ayhan Sarisu has assured econoffs that the deadline will not be extended further. Sarisu said that the main reason for the extension is that bidders are having difficulty completing their due diligence. Also, the PA is experiencing difficulty with Tekel,s real estate, which is to be conveyed to the state in satisfaction of unpaid taxes (Ref A).

¶4. (SBU) Post surmises, however, that the main reason for the delay is that Phillip Morris is having difficulty obtaining Competition Authority (CA) approval, which is a condition of the sale. Tekel has a 58% market share, while Phillip Morris has a 31% market share. The PA is trying to convince the CA to permit a sale to Phillip Morris without imposing potentially onerous antitrust conditions upon it, but to date has met with stiff resistance due to the 89% market share that the combined operations would achieve. The CA and others (including potential bidders) have urged the PA to sell the tobacco business in pieces, which would both attract more bidders (since the cost of entry would be lower) and lessen competitive concerns. However, the PA advises econoffs that it cannot sell the company by year end if it first must restructure it. Phillip Morris executives tell econoffs that, if they cannot obtain regulatory approval, BAT may have the edge.

¶5. (SBU) The Turkish press reports that the PA has instituted a pre-sale retirement program that will reduce Tekel,s workforce by 3,000 from 30,500, to &ease the way8 for Tekel,s new owner. However, private analysts believe that thousands more workers must go. (Per Ref A, Phillip Morris believes that over 90% of the tobacco operations workers are redundant.)

¶6. (SBU) Recent legislation promises Tekel a five year period of gradually declining restrictions on entry by competitors into the market, which the GOT openly admits is intended to maximize the sale price (Ref A). Although Tekel also receives tariff protection, the PA has advised econoffs that it has made no commitment as to future tariff levels.

¶7. (SBU) During a September 17 meeting, PA Acting VP Ayhan Sarisu told econoffs that sale terms are simple and standardized. Terms will be either all cash, or 50% cash with two yearly installments at 7% interest. In prior sales, the PA has generally granted credit terms to bidders, since most bidders have not had the financial wherewithal to pay cash. However, all of the investors interested in the Tekel tobacco operations can pay cash and, given the proffered interest rate, Sarisu expects that the winning bidder will choose to do so. The PA can either accept the highest bid, or put the finalists through an open auction, which could occur as early as November.

TUPRAS
¶8. (SBU) The PA intends to sell the state,s 66 percent stake, retaining only a &golden share8 to guarantee a continued supply of refined petroleum products to the Turkish military. There are no other restrictions on the purchaser,s ability to reduce capacity or production levels (currently, 85-88% of capacity). Although Tupras has an estimated 76% market share and supplies a majority of Petkim,s feedstock, PA VP Koktas claimed that the sale will not attract Competition Authority attention, since Tupras, market share will not increase as a result of the sale, and Tupras, individual refineries complement each other, and cannot realistically be sold other than as a going concern. (Nevertheless, a World Bank official with whom econoffs spoke expressed concern about the competition issues.)

¶9. (SBU) The sale has attracted much attention, from Russian companies, domestic investors, and consortiums. The PA is not aware of any interest by U.S. companies, but notes the possibility that they are participating in consortia. The PA expects 3-4 companies to be serious bidders. Analysts expect the company to sell for up to $2 billion.

¶10. (SBU) Bids had been due October 2 (itself an extended date), but the PA has extended the deadline to November 23. PA VP Koktas has given two reasons for the extension: First, bidders have requested additional time in which to complete their due diligence; and second, when Parliament reconvenes in October, the GOT will submit a new law that will liberalize the petroleum market. This law will permit refineries to engage in distribution activities, which should increase the value of Tupras. The GOT expects Parliament to approve this law quickly.

¶11. (SBU) In September, Tupras employees staged brief work stoppage. However, Koktas has told econoffs that Tupras itself does not have excess workers and that the stoppage was intended to protest the privatization of Petkim, whose workers belong to the same union.

PETKIM
¶12. (SBU) The unfortunate history of this privatization is detailed in Ref C. The bidding was reopened on August 26, 2003, with a November 18, 2003 deadline. The PA, and all five prior bidders, agree that at least $1 billion in capital will need to be invested in order to modernize the company. As such, the Uzan bid of $605 million, while criticized by President Erdogan and others as &cheap,8 would appear to be at the high end. PA expects a sale by year-end.

ELECTRICITY SECTOR
¶13. (SBU) Under the Electricity Market Law, the state's generation assets and most of the distribution assets (but not the transmission system) are to be privatized. The national grid has been divided into thirty-three distribution grids, and turned over to the PA, which to date has sold one. Prior to sale of the others, the independent regulatory agency EMRA is supposed to establish regional tariffs that will more closely reflect actual costs (and thus render the grids more attractive); however, per Ref E, this effort is currently deadlocked, for political reasons. Another problem is pending litigation that resulted when the GOT canceled 14 regional operating contracts in order to permit a full ownership sale. The World Bank thinks that the main problem is &too many players.8 No easy or quick solution can be expected.

NATIONAL LOTTERY
¶14. (SBU) PA officials have advised econoffs that the sale will be finalized early in 2004, and should produce around $1 billion. Turkish conglomerates Koc and Sabanci say they intend to submit a joint bid for the lottery license.

SEKER
¶15. (U) Three factories of the sugar parastatal, Seker,

have been prepared for sale in early 2004; the remaining 25 will be sold once legal and administrative problems are resolved.

TURK TELEKOM

¶16. (U) On September 17, Transportation Minister Binali Yildirim said the timetable for Telekom,s privatization will be announced at the end of October. Council of Ministers approval of a privatization strategy for Telekom is a requirement of the IMF,s Sixth Review. The GOT has approved regulations lifting Telekom,s landline monopoly at the end of the year. Turkish conglomerates Koc and Sabanci say they intend to submit a joint bid for Telekom. On this issue, the World Bank believes that the GOT is making &good progress.8

TURKISH AIRLINES

¶17. (SBU) The Ref D prediction that privatization in 2003 would be difficult has come to pass. On September 16, the PA announced that it is postponing privatization to 2004, due to lack of demand. The PA believes that the best option in current market conditions is a 10% IPO.

WORKFORCE REDUCTIONS

¶18. (SBU) The SEEs under the PA portfolio are thought to require a workforce of about 10,000 (Ref B). However, they currently employ 71,618 employees: 52,438 full-time workers; 6,538 &temporary workers8 (&temporary8 in name only); and 12,642 civil servants (who cannot be laid off and thus must be transferred). In a September 16 meeting, PA Employment Department Head Veysel Tekeloglu confirmed to econoffs that GOT,s year end IMF program workforce reduction target for all SEEs is 45,000 workers, of which 21,000 are to come from the PA SEEs. By the end of August, PA had achieved a reduction of 14,500 workers, so it is hopeful it will achieve its year end numbers. To this end, Tekel is the most important company in the PA portfolio, with 24,000 workers. If the PA can sell it by year end, then PA will easily meet its target. If Petkim and Tupras are also sold before year end, then some 9,000 more workers will be removed from the state payroll, thus ensuring that GOT,s overall SEE workforce reductions will be met.

COMMENT

¶19. (SBU) If (as the PA and GOT confidently predict) Tekel, Tupras and Petkim are sold close to schedule (by year end or, at the latest, the end of January, 2004), the 2003 program is likely to be judged by the IFIs to be acceptable. PA management recognizes that meeting its 2003 targets is but the end of the beginning, and has already started working on its 2004 privatization program (2003 was the first year in which it had a formal program).

¶20. (SBU) Challenges remain. The PA is unable to provide purchasers with zoning variances lasting more than five years Also, a recent (and generally favorable) World Bank report makes a number of criticisms: SEE profits and privatization sale proceeds have been used to finance the unprofitable holdings rather than being returned to the Treasury and used to retire debt (pending legislation should solve this problem); the requirement that the Privatization High Council approve all sales has forced even small divestitures to be recycled several times, significantly lowering their value and reducing transparency; and a few particularly sensitive privatizations (e.g., Turk Telekom are not controlled by the PA. From a broader policy perspective, the seemingly single-minded focus on maximizing the proceeds from privatization in some cases deters market liberalization and competition, as protected or dominant market positions are at least partially passed on to the new owners (e.g., Tekel, Tupras).
EDELMAN